

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF NEBRASKA**

)	
In the Matter of SourceGas Distribution LLC,)	
Golden, Colorado, seeking an order)	
authorizing it to put into effect a system safety)	Docket No. NG-0078
and integrity rider tariff and system safety)	
and integrity rider charge.)	
)	

**DIRECT TESTIMONY AND EXHIBITS
OF WILLIAM DUNKEL
ON BEHALF OF
THE NEBRASKA PUBLIC ADVOCATE**

August 21, 2014

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I. Introduction

Q. Please state your name and business address.

A. My name is William Dunkel. My business address is 8625 Farmington Cemetery Road,
Pleasant Plains, Illinois 62677.

Q. What is your present occupation?

A. I am a consultant providing services in utility regulatory proceedings. I am the principal
of William Dunkel and Associates, which was established in 1980. Since that time, I have
regularly provided expert consulting services in utility regulatory proceedings throughout
the country. I have participated in over 250 state regulatory proceedings before over one-
half of the state commissions in the United States. I have participated in utility regulatory
proceedings for over 30 years.

I provide, or in the past have provided, services in utility regulatory proceedings to the
following clients:

The Public Utility Regulatory Commission or the Staffs in the States of:

Arkansas	Maryland
Arizona	Mississippi
Delaware	Missouri
D.C.	New Mexico
Georgia	Virginia
Guam	Washington
Illinois	U.S. Virgin Islands
Kansas	

The Office of the Public Advocate, or its equivalent, in the States of:

Alaska	Maryland
California	Michigan
Colorado	Missouri
District of Columbia	New Jersey
Georgia	New Mexico

1	Hawaii	Ohio
2	Illinois	Pennsylvania
3	Indiana	Utah
4	Iowa	Washington
5	Maine	
6		

7 The Department of Administration in the States of:

8	Illinois	South Dakota
9	Minnesota	Wisconsin
10		

11 **Q. Are you a member of any depreciation professional organization?**

12 A. Yes. I am a senior member in good standing of the Society of Depreciation Professionals.
13 I made a presentation pertaining to Current Depreciation Issues in State Rate Case
14 Proceedings at the Society of Depreciation Professionals 25th Annual Meeting held
15 September 2011 in Atlanta, GA.

16 **Q. Did you prepare an Appendix that describes your qualifications?**

17 A. Yes. My qualifications are shown on Appendix A.

18 **Q. What type of client does your firm most frequently serve?**

19 A. Nationwide my firm participates on behalf of the Commission Staffs or State Utility
20 Regulatory Commissions in the majority of our cases. In the past five years 65% of my
21 firm's cases have been on behalf of the Commission Staffs or State Utility Regulatory
22 Commissions. In the past five years 52% of my personal cases have been on behalf of the
23 Commission Staffs or State Utility Regulatory Commissions. As a frequent Staff witness,
24 I understand that proper depreciation rates are fair to all parties, including investors,

1 current ratepayers and future ratepayers.¹ I have incorporated this proper concept into my
2 recommendations in this proceeding.

3 **Q. On whose behalf are you testifying?**

4 A. I am testifying on behalf of the Nebraska Public Advocate (“Public Advocate” or “PA”)

5 **Q. What issues will you address in this testimony?**

6 A. I will address certain issues depreciation-related issues pertaining to the proposed new
7 Safety and Integrity Rider (SSIR) charge that SourceGas is proposing in Docket No.
8 NG-0078. In response to discovery, SourceGas has indicated that the proposed SSIR is
9 not following the statutory requirements that apply to the Infrastructure System
10 Replacement (ISR) charge.²

11 I am not addressing the ISR charge which SourceGas proposed in Docket No.
12 NG-0072.1.

13 **II. Summary**

14 **Q. Please summarize the major issues you will address.**

15 A. The major issues are summarized below. All of the following will be addressed in more
16 detail later in this testimony.

- 17 (1) Any need for a higher facility replacement level now is at least in part “catch up”
18 for the fact that in recent years SourceGas’ actual retirements have been low.
- 19 (2) SourceGas has accumulated over a \$27 million reserve surplus from the
20 ratepayer-provided funds. A surplus in the accumulated depreciation reserve
21 means that more money was collected from ratepayers in the past through

¹ I also followed the depreciation requirements as contained in the FERC Uniform Systems of Accounts (USOA). In addition, the “Public Utility Depreciation Practices” published by NARUC in 1996 contains detailed practices for calculating utility regulatory depreciation rates under USOA, which I follow.

² SourceGas response to Information Request No. PA-21 in Docket No. NG-0079.

1 depreciation rates than should have been collected, knowing what we know now.
2 \$27 million is a significant surplus for this size of company.

3 (3) In recent years, far more ratepayer-supported depreciation expense has been
4 booked into the depreciation reserve, than has been withdrawn as the result of the
5 actual retirements.

6 The ratepayer-supported depreciation expense is booked into the depreciation
7 reserve, and money is withdrawn from the depreciation reserve when investments
8 actually retire. In the past 6 years over \$16 million of the ratepayer-supported
9 depreciation expense was booked into the accumulated depreciation reserve for
10 Account 376, Mains.³ However, because of the low level of actual retirements,
11 less than \$2 million was debited out of the Mains accumulated depreciation
12 reserve. This is shown below:

³ Response to Information Request No. PA-43 in Docket No. NG-0079. Less than \$6 thousand of gross salvage was also credited into the accumulated depreciation reserve (Response to Information Request No. PA-29 in Docket No. NG-0079). Depreciation expense and gross salvage go into (“credit”) the accumulated depreciation reserve. When investments retire, the investment retired and the cost of removal are taken out (“debit” or “charged”). The Uniform System of Accounts (18CFR201) states:

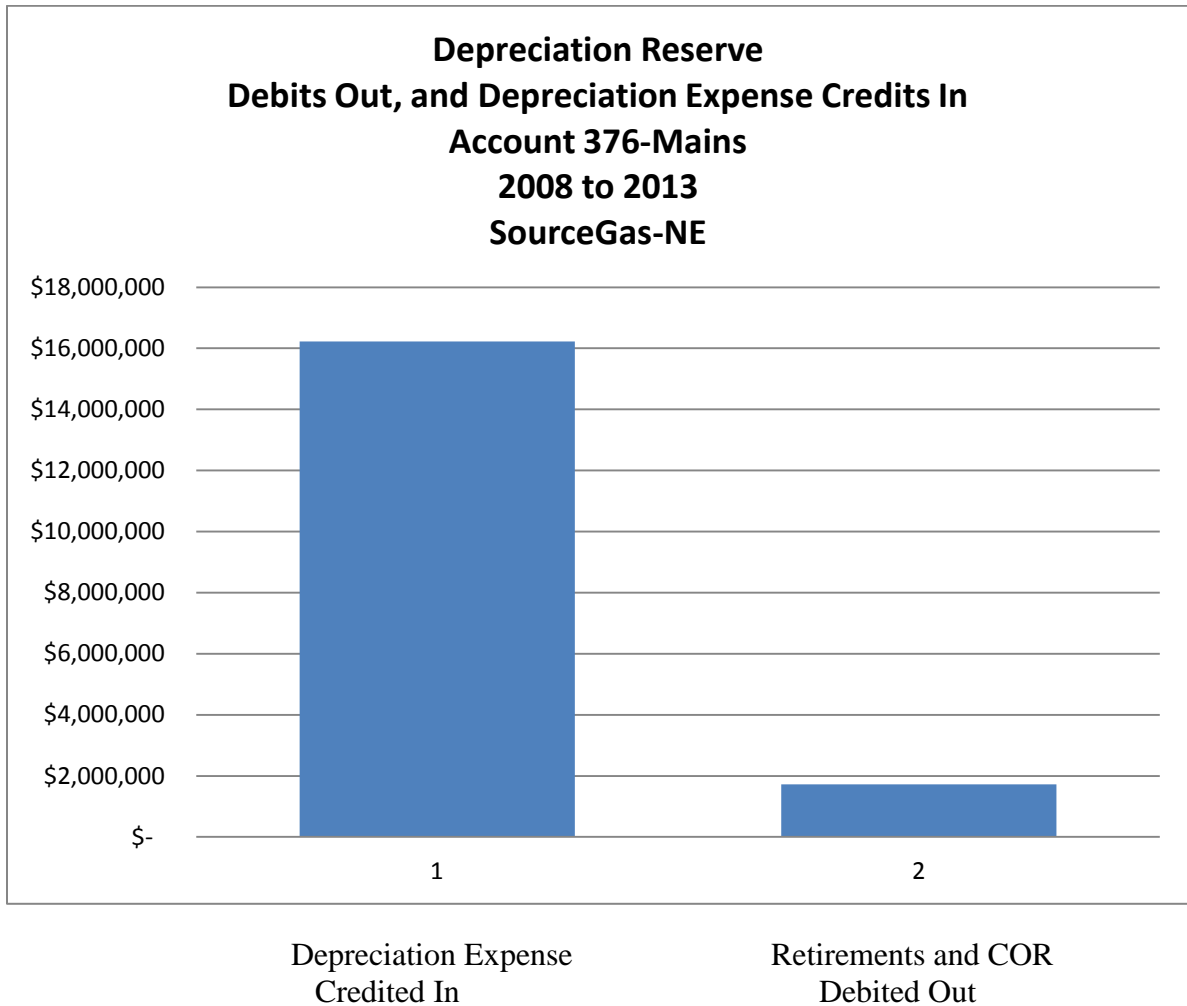
108 Accumulated provision for depreciation of gas utility plant.

A. This account shall be credited with the following: (1) Amounts charged to account 403, Depreciation Expense...

B. At the time of retirement of depreciable gas utility plant, this account shall be charged with the book cost of the property retired and the cost of removal and shall be credited with the salvage value and any other amounts recovered, such as insurance.

1

Chart 1:



2

This is shown on Exhibit WDA-3.

3

The difference between (1) what was collected from ratepayers through depreciation and (2) the low level of actual retirements, is one reason SourceGas has accumulated a surplus in the depreciation reserve in excess of \$27 million.

5

6

(4) In addition, using SourceGas' own projections, the depreciation expense collected from ratepayers in 2014 will still deposit far more money into the accumulated depreciation reserve than will be withdrawn by retirements in 2014, even when the retirements resulting from the 2014 SSIR and ISR projects are included.

8

9

10

(5) In recent years SourceGas has actually been retiring much less than the retirements implied in the depreciation rates that are being recovered in prices charged to ratepayers.

11

12

1 For the largest account ratepayers have been paying a depreciation rate based on
2 retirement levels that imply approximately a 33 year Average Service Life.
3 However the analysis of what SourceGas has actually retired in the recent past
4 indicates an Average Service Life of 65 years.

5 The Average Service Life starts when the investment goes into service, and ends
6 when the investment retires. Therefore, a longer Average Service Life indicates a
7 lower overall level of retirements that a shorter Average Service Life, everything
8 else equal.

9 SourceGas has actually been retiring much less than the retirements implied in the
10 depreciation rates that are being recovered in prices charged to ratepayers.

11 **III. Retirements are A Normal Part of the Utility Business, and are Expected to Occur**

12 **Q. What is one aspects of the SourceGas SSIR proposal?**

13 A. SourceGas says because of regulatory and legislative activities, future safety and integrity
14 activities may be higher than in past.⁴

15 **Q. If regulatory and legislative activities cause existing facilities to be retired, does that**
16 **necessarily mean that an additional charge should be paid by the ratepayers?**

17 A. No. The depreciation rates charged to ratepayers are based on the fact that investments
18 are expected to retire. If no investments were expected to retire, then the depreciation rate
19 charged to ratepayers would be zero.

20 **Q. Are retirements or prospective retirements caused by regulatory and legislative**
21 **requirements part of what is to be recovered in the depreciation expense that is**
22 **charged to ratepayers?**

23 A. Yes. Retirements or prospective retirements, caused by the “requirements of public
24 authorities” are part of the retirements included in the definition of “depreciation.” The
25 Uniform System of Accounts (USOA) definition of Depreciation is:

⁴ Direct Testimony of Charles A Bayles, Docket No. NG-0078.

1 B. *Depreciation*, as applied to depreciable gas plant, means the loss in
2 service value not restored by current maintenance, incurred in connection
3 with the consumption or prospective retirement of gas plant in the course
4 of service from causes which are known to be in current operation and
5 against which the utility is not protected by insurance. Among the causes
6 to be given consideration are wear and tear, decay, action of the elements,
7 inadequacy, obsolescence, changes in the art, changes in demand and
8 requirements of public authorities, and, in the case of natural gas
9 companies, the exhaustion of natural resources.

10 (Emphasis added, Source: 18CFR201 "Definitions")
11

12 **IV. SourceGas has a \$27 million Reserve Surplus**

13 **Q. Did the review of the data in these cases produce an interesting fact?**

14 A. Yes. Mr. Watson's own calculations show that there is a large surplus in the accumulated
15 depreciation reserve. A surplus in the accumulated depreciation reserve means that more
16 money was collected from ratepayers in the past through depreciation rates than should
17 have been collected, knowing what we know now.

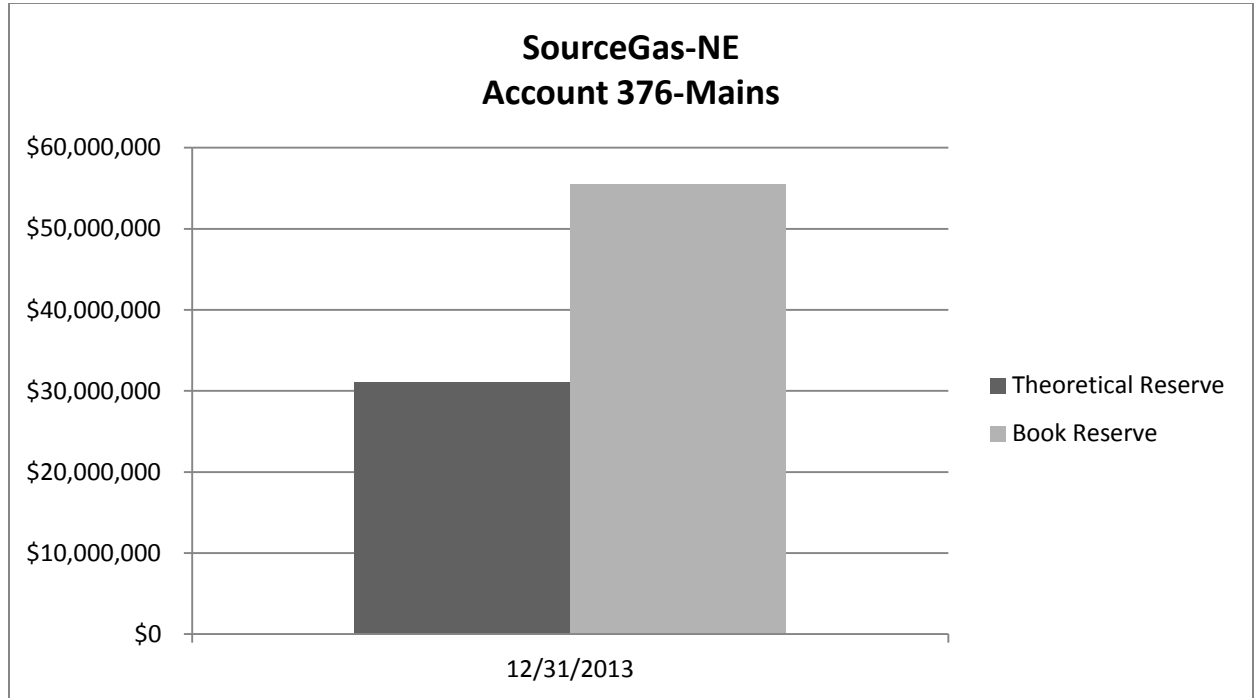
18 SourceGas now has over \$27 million of surplus accumulated depreciation reserve that has
19 been collected from depreciation charges to past ratepayers.

20 **Q. Can you demonstrate that there is a large surplus in the SourceGas Nebraska**
21 **accumulated depreciation reserve (specifically named Account 108, Accumulated**
22 **Provision for Depreciation)?**

23 A. Yes. To avoid controversy I will even make this demonstration using entirely Mr.
24 Watson's own figures. The largest part of the surplus is the \$24.5 million surplus in the
25 Distribution Mains Account. For the largest account, Account 376, Distribution Mains,
26 Mr. Watson calculated that the amount that theoretically should be in the accumulated
27 depreciation reserve is \$30,989,783. However, his data also shows there is actually
28 \$55,503,668 in that accumulated depreciation reserve.

1 There is a surplus of \$24,513,885 in the Mains accumulated depreciation reserve, using
2 Mr. Watson's own figures.⁵ This is shown below:

3 Chart 2:



4
5 Page 23 of Public Utility Depreciation Practices published by NARUC (August 1996)

6 states the "theoretical reserve"

7 "may be defined as an estimate of the balance which should be in the
8 depreciation reserve today, considering the distribution by ages of existing
9 property, and assuming the correctness of the currently effective service
10 life parameters and net salvage percentages." (Emphasis added).

11 In the Distribution Mains account, SourceGas now has over \$24.5 million of surplus
12 accumulated reserve that has been collected from depreciation charges to past ratepayers.
13 \$24.5 million more money was collected from ratepayers in the past through depreciation
14 rates than should have been collected, knowing what we know now.

⁵ \$55,503,667.76 actually in the reserve - \$30,989,783.06 that should be in the reserve = \$24,513,884.70 surplus.

1 **Q. Can you demonstrate that the amounts used above were provided by Mr. Watson?**

2 A. Yes.

3 Attached as Exhibit WDA-1⁶ is Mr. Watson's workpaper in which he calculates that as of
4 12/31/2013 the amount that theoretically should be in the Account 37600, Mains,
5 accumulated depreciation reserve ("Theo Res") is \$30,989,783.06. The "theoretical
6 reserve" is "an estimate of the balance which should be in the depreciation reserve today"
7 knowing what we know now.⁷

8 Attached as Exhibit WDA-2 is a page from Mr. Watson's Depreciation Study in Docket
9 No. NG-0079 which shows that as of 12/31/2013 the amount that actually was in the
10 Account 37600, Mains, Accumulated Depreciation reserve was \$55,503,667.76.⁸

11 There is a surplus of \$24,513,885 in the Mains accumulated depreciation reserve, using
12 Mr. Watson's own figures.⁹

13 The \$24.5 million surplus is a significant amount for this size of company; for example
14 this reserve surplus equals 24% of the investment in this account.¹⁰

⁶ See "37600 Total" on page 3 of Exhibit WDA-1. Exhibit WDA-1 is from SourceGas response to Information Request No. PA-1, in Docket No. NG-0079, "Accrual Rate Final".

⁷ Page 23 of Public Utility Depreciation Practices published by NARUC (August 1996) states the "theoretical reserve" "may be defined as an estimate of the balance which should be in the depreciation reserve today, considering the distribution by ages of existing property, and assuming the correctness of the currently effective service life parameters and net salvage percentages." (Emphasis added).

⁸ Appendix A of the Watson Depreciation Study, Exhibit DAW-4 in Docket No. NG-0079.

⁹ \$55,503,667.76 actually in the reserve - \$30,989,783.06 that should be in the reserve = \$24,513,884.70 surplus.

¹⁰ \$24,513,885 reserve surplus/\$102,948,207 Plant in Service = 23.8%.

1 **Q. Above you discussed the largest account. What is the surplus in the accumulated**
2 **depreciation reserve when all accounts that are in the SourceGas Depreciation**
3 **Study are included?**

4 A. When all accounts that are in the SourceGas Depreciation Study are included, the
5 depreciation reserve surplus is \$27,484,405.¹¹ The previously discussed \$24.5 million
6 surplus in the Mains account constitutes the vast majority of this total.

7 **V. In Recent Years, 9 Times as Much Was Booked into the Mains**
8 **Depreciation Reserve from Ratepayer-Supported Depreciation Expense, as**
9 **was Withdrawn as the Result of Actual Retirements.**

10 **Q. What is one reason that SourceGas has accumulated this large surplus in the**
11 **accumulated depreciation reserve?**

12 A. In the past six years 9 times as much was booked into the depreciation reserve for Mains
13 from the ratepayer-supported depreciation expense, as was withdrawn as the result of
14 actual retirements.

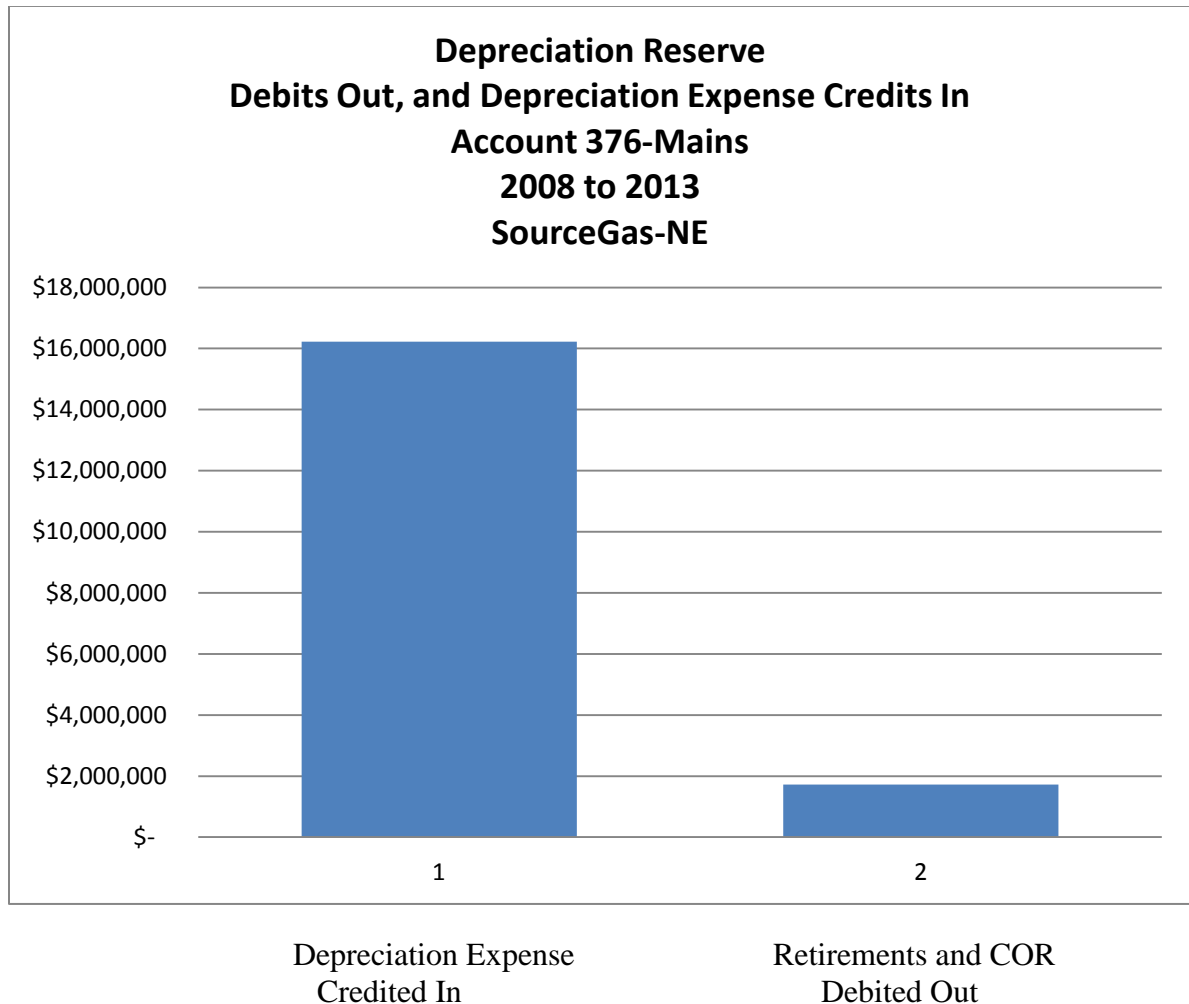
15 In past years the SourceGas actual retirements in Nebraska have been relatively low. The
16 depreciation expense (which is recovered from ratepayers) is booked into the
17 accumulated depreciation reserve. Money is debited out of the accumulated depreciation
18 reserve when SourceGas actually retires investments. Money from the ratepayer-
19 supported depreciation expense has been flowing into the accumulated depreciation
20 reserve. However because of the low level of actual retirements, much less money has
21 been flowing out of the accumulated depreciation reserve.

¹¹ See Appendix A of the Watson Depreciation Study, Exhibit DAW-4 in Docket NG-0079 (attached as Exhibit WDA-2) and SourceGas response to Information Request No. PA-1, in Docket No. NG-0079, "Accrual Rate Final" (attached as Exhibit WDA-1).

For example, in 2012 almost \$3 million of ratepayer-supported depreciation expense was booked into the accumulated depreciation reserve for Mains, but because of the low level of actual retirements, less than \$260,000 was debited out.¹²

Other recent years are similar. In total for the last six years, shown below is the amount of the ratepayer-supported depreciation expense that was booked into the accumulated depreciation reserve for Mains, compared to the amount withdrawn from the accumulated depreciation reserve:

Chart 3:



¹² See SourceGas Responses to Information Request Nos. PA-29 and PA-43 in Docket No. NG-0079. The amounts are also shown on page 2 of Exhibit WDA-3, attached.

1
2 This is shown on Exhibit WDA-3.

3 In total in the last six years, over \$16 million of ratepayer-supported depreciation expense
4 was credited into the accumulated depreciation reserve for Mains, but less than \$1.8
5 million was debited out. The amount debited out is (1) the original cost of the
6 investments actually retired plus (2) the associated cost of removal.

7 In the past six years 9 times as much was booked into the depreciation reserve for Mains
8 from the ratepayer-supported depreciation expense, as was withdrawn as the result of
9 actual retirements.¹³

10 I take no position pertaining to the physical condition of the SourceGas Mains. However,
11 if there are concerns as to the condition of the Mains, it is reasonable to believe that one
12 relevant fact is that in the past SourceGas has had low retirements. These retirements
13 have been so low that SourceGas has accumulated more than a \$24 million surplus in the
14 accumulated depreciation reserve for the Mains account.

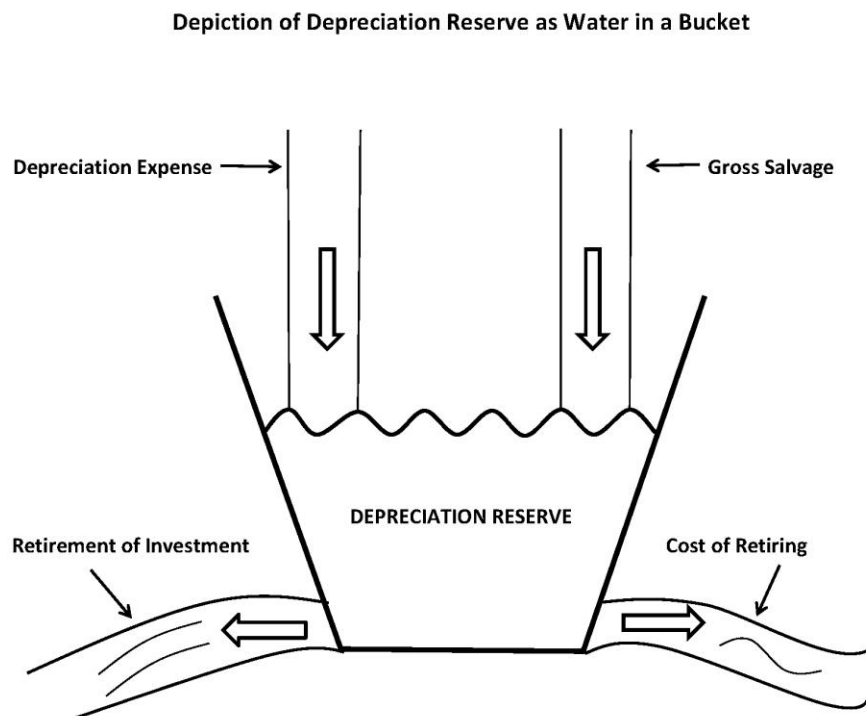
15 When all of the accounts in the Depreciation Study are considered, the surplus in the
16 accumulated depreciation reserve is over \$27 million.

17 Any need for a higher replacement rate now is at least in part “catch up” for the fact that
18 in recent years SourceGas retirements have low.

¹³ This testimony does not imply that the credits in and the debits out of the accumulated depreciation reserve have to be equal every year. However, by the time all investments in an account retire, the total credits in should at least approximately equal the total debits out. The fact that SourceGas has a large reserve surplus indicates that more depreciation expenses has been collected from past ratepayers than should have been collected, knowing what we know now.

1 **Q. Please explain what flows into and out of the accumulated depreciation reserve.**

2 A. The relationship of these items is sometimes illustrated by picturing the accumulated
3 depreciation reserve as water in a bucket.



Drawing No. 1

4 This drawing is also attached as Exhibit WDA-4.

Both the depreciation expense and the gross salvage go into the depreciation reserve (“credit”). Both the cost of retiring and an amount equal to the investments that actually retire are taken out of the depreciation reserve (“debit”).¹⁴

For SourceGas in Nebraska, the ratepayer-supported depreciation expense going into the “bucket” has been much larger than the amount going out of the “bucket”. As a result of this difference, the level in the “bucket” (accumulated depreciation reserve) has risen, and is now more than \$24 million higher than it should be for the Mains account.

One reason a large surplus has developed is because in recent years the money collected from ratepayers that goes into the depreciation reserve has greatly exceeded the money going out of the depreciation reserve as the result of retirements.¹⁵

VI. Even in 2014, the Ratepayer-Supported Depreciation Expense Projected to go into the Reserve Greatly Exceeds the Expected Withdrawals.

Q In this proceeding does SourceGas project that retirements in the year 2014 will be much higher than the retirements have been in recent years?

A. Yes. SourceGas documents show that it projects retirements in the year 2014 that will be much higher than the retirements have been in recent years. In its revenue requirement calculation SourceGas states it expects to retire \$1,658,589 from the Distribution Mains

¹⁴ See description of Account 108 parts (A) and (B) in 18 CFR 201-Uniform System of Accounts (USOA). The Uniform System of Accounts (18CFR201) states:

108 Accumulated provision for depreciation of gas utility plant.

A. This account shall be credited with the following: (1) Amounts charged to account 403, Depreciation Expense...

B. At the time of retirement of depreciable gas utility plant, this account shall be charged with the book cost of the property retired and the cost of removal and shall be credited with the salvage value and any other amounts recovered, such as insurance.

¹⁵ The amount of salvage and cost of removal has been very minor in recent years for Account 376. See Appendix D of the Company Depreciation Study, Exhibit DAW-4 in Docket No. NG-0079.

1 account in the year 2014.¹⁶ The \$1,658,589 expected 2014 retirement amount includes all
2 expected Distribution Mains retirements in 2014, specifically including retirements from
3 SSIR projects, and retirements from non-SSIR project and retirements from ISR
4 projects.¹⁷

5 For comparison the actual retirements have averaged only \$287,272 in the last 6 years
6 (2008-2013) in this account.

7 **Q. Even if the 2014 Distribution Mains retirements are \$1,658,589 in 2014 as**
8 **SourceGas projects,¹⁸ would retiring that amount (and the associated COR) from**
9 **the accumulated depreciation reserve equal the amount of ratepayer-supported**
10 **depreciation expense that is expected to flow into the accumulated depreciation**
11 **reserve in 2014?**

12 A. No. SourceGas' own projection for 2014 is that \$1,830,971 more will be credited into
13 the Distribution Mains accumulated depreciation reserve than will be debited out.¹⁹

14 SourceGas projects that \$3,589,503 will be credited into the Distribution Mains
15 accumulated depreciation reserve in 2014.²⁰

16 The vast majority of the \$3,589,503 amount²¹ projected to be credited into the reserve is
17 from the \$3,580,155 projected depreciation expense for 2014.

¹⁶ SourceGas response to Information Request No. PA-11, in Docket No. NG-0079, "Attachment PA-11," tab "F-1 Consol" Schedule F2, column 11. In addition the COR is expected to be \$99,941 in 2014 (column 14) as will be discussed.

¹⁷ SourceGas response to Information Request No. PA-33 in Docket No. NG-0079.

¹⁸ SourceGas response to Information Request No. PA-11, in Docket No. NG-0079, "Attachment PA-11," tab "F-1 Consol" Schedule F2, column 11.

¹⁹ SourceGas response to Information Request No. PA-11, in Docket No. NG-0079, "Attachment PA-11," tab "F-1 Consol" Schedule F2, column 17.

²⁰ SourceGas Response to Information Request No. PA-11 in Docket No. NG-0079, File: "Attachment PA-11," Tab: "F-1 Consol" Schedule F2 column 10 plus column 13.

1 SourceGas' own projection for 2014 is that a total of \$1,758,531 will be debited out of
2 the Distribution Mains accumulated depreciation reserve. This includes \$1,658,590
3 retirements plus \$99,941 cost-of-removal.²²

4 Even including retirements from everything, including retirements from SSIR projects,
5 retirements from non-SSIR project and retirements from ISR projects, the \$3,580,155 of
6 ratepayer-supported depreciation expense that is projected to flow into the Distribution
7 Mains accumulated depreciation reserve in 2014 would still be over twice the \$1,758,531
8 amount expected to be withdrawn from the Distribution Mains reserve in 2014, using the
9 Company's own projections.

10 Even at the level of retirements projected for 2014, the ratepayer-supported depreciation
11 expense flowing into the depreciation reserve more than covers those retirements and
12 cost-of-removal, and also grows the accumulated depreciation reserve to help cover
13 future retirements as well.

14 **Q. The expected 2014 Distribution Mains depreciation expense of \$3,580,155 discussed**
15 **above was calculated by SourceGas using the current depreciation rates (specifically**
16 **the 3.00% depreciation rate for Account 376, Distribution Mains). However, in**
17 **Docket No. NG-0079 SourceGas proposes to reduce the depreciation rates it uses for**
18 **booking purposes. The new depreciation rate for booking purposes would be 1.19%**
19 **for Distribution Mains under the SourceGas proposal. If overall lower depreciation**

²¹ SourceGas Response to Information Request No. PA-11 in Docket No. NG-0079, File: "Attachment PA-11," Tab: "F-1 Consol" Schedule F2 column 10 plus column 13. A small amount of salvage is expected to be credited in, in addition to the depreciation expense.

²² SourceGas Response to Information Request No. PA-11 in Docket No. NG-0079, File: "Attachment PA-11," Tab: "F-1 Consol" Schedule F2 column 11 plus column 14.

1 **rates are adopted in Docket No. NG-0079, would that reduce the amount of**
2 **depreciation expense collected in the prices charged ratepayers?**

3 A. Under the SourceGas proposal, absolutely not. SourceGas does not propose to change the
4 depreciation rates that are recovered in prices charged to ratepayers; instead SourceGas
5 only proposes to change now the depreciation rates it records on its books. The base rates
6 charged to ratepayers would not change, and therefore would continue to be based on the
7 current depreciation rates, which include a 3.00% depreciation rate for Distribution
8 Mains.

9 In addition, the SSIR charge to ratepayers that SourceGas proposes in this proceeding is
10 calculated at the current depreciation rates, which include a 3.00 % depreciation rate for
11 Distribution Mains.

12 As an analogy, assume you have been paying \$900 per month in rent, and the landlord
13 has been recording on the landlord's books that you pay \$900 per month. The landlord
14 starts recording on the landlord's books that you only pay \$400 per month; however you
15 continue to pay \$900. The landlord changing what is recorded on the landlord's books
16 does not change the fact that you are actually paying \$900 per month.

17 This issue is discussed in more detail in my testimony in Docket No. NG-0079.

18 **VII. SourceGas has Actually Been Retiring Much Less than the Retirements**
19 **Implied in the Depreciation Rates That Are Being Charged to Ratepayers**

20 Q. **Has SourceGas actually been retiring much less than the retirements implied in the**
21 **depreciation rates that are being charged to ratepayers?**

22 A. Yes. SourceGas has actually been retiring much less than the retirements implied in the
23 depreciation rates that are being recovered in prices charged to ratepayers.

1 For the largest account, Mains, ratepayers have been paying a depreciation rate based on
2 retirement levels that imply approximately a 33 year Average Service Life. However the
3 analysis of what SourceGas has actually retired in the past indicates an Average Service
4 Life of 65 years.

5 The Average Service Life starts when the investment goes into service, and ends when
6 the investment retires. Therefore a longer Average Service Life indicates a lower overall
7 rate of retirements that a shorter Average Service Life, everything else equal.

8 **Q. What Average Service Life is implied by the current 3.00% depreciation rate for**
9 **Account 376, Mains?**

10 A. Column (10) of Company Schedule F-1 shows that the “Present” Depreciation rate is
11 3.00% for Dist-Mains. SourceGas’ own workpaper that supports this 3.00% “Present”
12 depreciation rate states that for Account 376, Distribution-Mains the “Implied Life
13 (Years)” is “33”.

14 A copy of this SourceGas workpaper which shows that SourceGas says the “Implied
15 Life” is “33” years for the present 3.00% depreciation rate is attached as Exhibit
16 WDA-5.²³

17 **Q. What Average Service Life is indicated by Mr. Watson’s own study of the past**
18 **actual retirements in this Mains account?**

19 A. Mr. Watson’s own analysis of the past actual retirements in this Distribution Mains
20 account show that these past actual retirements indicate an Average Service Life of 65

²³ Column H, line 83 on the “Depreciation Rates” tab of “Attachment PA-39” provided by SourceGas in response to Information Request No. PA-39 in Docket No. NG-0078.

1 years.²⁴ The Observed Life data was determined using the past Source Gas actual
2 retirements in the Distribution Mains account.²⁵

3 **Q. Can you demonstrate Mr. Watson’s analysis which indicated a 65 year Average**
4 **Service Life was determined using the past SourceGas actual retirements in the**
5 **Mains account.**²⁶

6 A. Yes. Exhibit WDA-6 is Mr. Watson’s workpaper that he used to calculated the Observed
7 Life Table for this account.²⁷ In the “Retirements During Interval” column he included
8 the retirements that had occurred in this account during the years 2004 through 2013.²⁸
9 Using this data, his analysis on page 21 of his Depreciation Study²⁹ shows that these past
10 actual SourceGas retirement amounts indicate an Average Service Life of 65 years. The
11 past retirement amounts would have to have been much higher for this analysis to
12 indicate an Average Service Life of 33 years.

13 **Q. What has been demonstrated in this section?**

14 A. For the largest account, Mains, ratepayers have been paying a depreciation rate based on
15 retirement levels that imply approximately a 33 year Average Service Life. However, the
16 analysis of what SourceGas has actually retired in the recent past indicates an Average
17 Service Life of 65 years. In recent years SourceGas has not been actually retiring
18 Distribution Mains investments as rapidly as implied by the 3.00% depreciation rate that

²⁴ Page 21 and Appendix C of the SourceGas Depreciation Study, Exhibit DAW-4 in Docket No. NG-0079. The projected Average Service Life is sometimes called the Projection Life.

²⁵ Page 10 of the SourceGas Depreciation Study, Exhibit DAW-4 in Docket No. NG-0079. The Observed Life Data is called “Actual Data” on page 21 of the Company Depreciation Study.

²⁶ Page 10 of the SourceGas Depreciation Study, Exhibit DAW-4 in Docket No. NG-0079. The Observed Life data was called “Actual Data” on page 21 of the Company Depreciation Study. I am not objecting to the method Mr. Watson used to determine the 65 year Average Service Life.

²⁷ “376 P89-13 E04-13.PDF” provided in response to Information Request No. PA -1 in Docket No. NG-0079. This is the data Mr. Watson presented on page 21 of his Depreciation Study (Exhibit DAW-4 in Docket No. NG-0079).

²⁸ Provided that they were also retirements of investments that went into service during the years 1989 to 2013.

²⁹ Exhibit DAW-4 in Docket No. NG-0079.

1 has been charged to ratepayers, and will continue to be charged to ratepayers until the
2 next general rate case.³⁰

3 **Q. Why do you use Account 376, Distribution Mains, as the example in many of the**
4 **prior discussions?**

5 A. Account 376, Distribution Mains, is by far the largest account. The investment in
6 Account 376 is over 4 times the investment in the second largest account, Account 380,
7 Services.³¹ The investment in Account 376, Distribution Mains, is 64% of the total
8 investment in all accounts included in the Depreciation Study.³²

9 When preparing my recommendations, I did consider all accounts in the Depreciation
10 Study.

11 **VIII. Conclusion**

12 **Q. Please summarize the major points of your testimony.**

13 A. The major issues are summarized below.

14 (1) Any need for a higher facility replacement level now is at least in part “catch up”
15 for the fact that in recent years SourceGas’ actual retirements have been low.

16 (2) SourceGas has accumulated over a \$27 million reserve surplus from the
17 ratepayer-provided funds. A surplus in the accumulated depreciation reserve
18 means that more money was collected from ratepayers in the past through
19 depreciation rates than should have been collected, knowing what we know now.
20 \$27 million is a significant surplus for this size of company.

³⁰ In proper depreciation theory, the depreciation rates are not designed to provide the money needed to fund the new facilities that may replace the retiring facilities. Instead depreciation rates are properly designed to recover the loss of service value of the existing facilities, as specified in more detail in the USOA.

³¹ See Appendix A of Exhibit DAW-4 in Docket No. NG-0079. $\$102,948,207$ (acct 376 investment) / $\$21,784,000$ (acct 380 investment) = 4.7.

³² See Appendix A of Exhibit DAW-4 in Docket No. NG-0079. $\$102,948,207$ (acct 376 investment) / $\$160,074,236$ (grand total) = 64.31%.

1 (3) In recent years, far more ratepayer-supported depreciation expense has been
2 booked into the depreciation reserve, than has been withdrawn as the result of the
3 actual retirements.

4 The ratepayer-supported depreciation expense is booked into the accumulated
5 depreciation reserve, and money is withdrawn from the accumulated depreciation
6 reserve when investments actually retire. In the past 6 years over \$16 million of
7 the ratepayer-supported depreciation expense was booked into the accumulated
8 depreciation reserve for Account 376, Mains.³³ However, because of the low
9 level of actual retirements, less than \$2 million was debited out of the Mains
10 accumulated depreciation reserve in this same time period.

11 The difference between (1) what was collected from ratepayers through
12 depreciation and (2) the low level of actual retirements, is one reason SourceGas
13 has accumulated a surplus in the accumulated depreciation reserve in excess of
14 \$27 million.

15 (4) In addition, using SourceGas' own projections, the depreciation expense collected
16 from ratepayers in 2014 will still deposit far more money into the accumulated
17 depreciation reserve than will be withdrawn by retirements in 2014, even when
18 the retirements resulting from the 2014 SSIR and ISR projects are included.

19 (5) In recent years SourceGas has actually been retiring much less than the
20 retirements implied in the depreciation rates that are being recovered in prices
21 charged to ratepayers.

22 For the largest account ratepayers have been paying a depreciation rate based on
23 retirement levels that imply approximately a 33 year Average Service Life.
24 However the analysis of what SourceGas has actually retired in the recent past
25 indicates an Average Service Life of 65 years.

26 The Average Service Life starts when the investment goes into service, and ends
27 when the investment retires. Therefore, a longer Average Service Life indicates a

³³ Response to Information Request No. PA-43 in Docket No. NG-0079. Less than \$6 thousand of gross salvage was also credited into the accumulated depreciation reserve (Response to Information Request No. PA-29 in Docket No. NG-0079). Depreciation expense and gross salvage go into ("credit") the accumulated depreciation reserve. When investments retire, the investment retired and the cost of removal are taken out ("debit" or "charged"). The Uniform System of Accounts (18CFR201) states:

108 Accumulated provision for depreciation of gas utility plant.

A. This account shall be credited with the following: (1) Amounts charged to account 403, Depreciation Expense...

B. At the time of retirement of depreciable gas utility plant, this account shall be charged with the book cost of the property retired and the cost of removal and shall be credited with the salvage value and any other amounts recovered, such as insurance.

1 lower overall level of retirements that a shorter Average Service Life, everything
2 else equal.

3 SourceGas has actually been retiring much less than the retirements implied in the
4 depreciation rates that are being recovered in prices charged to ratepayers.

5 **Q. Are you presenting the specific PA recommendations pertaining to the new**
6 **proposed SSIR charge?**

7 A. No. Another PA witness that will be presenting the specific PA recommendations
8 pertaining to the proposed SSIR charge.

9 **Q. Does this conclude your Direct Testimony?**

10 A. Yes.